White Paper Euronext

Statistics from 2024 underline the trend of retail investors being increasingly disincentivised from trading simple bonds. Reviews of the PRIIPs and MiFID II frameworks must prioritise enhancing the participation of retail investors.

In the years following the introduction of the PRIIPs, and the MiFID II/MiFIR frameworks, it is evident that, despite the initial aim of safeguarding retail investors and restoring trust, the range of investment opportunities in corporate bonds accessible to retail investors has considerably dwindled, resulting in reduced portfolio diversification. It has been due to various factors, including the definitions in PRIIPs, and MIFID II's "Target Market" requirements for each issued bond.

Our recommendations in the context of the Retail Investment Strategy (RIS) proposal:

The RIS proposal aims to enhance retail investors' involvement in capital markets. This initiative serves as another cornerstone of the CMU project and plays a vital role in fostering the dynamism of the European economy. However, to genuinely achieve this objective, EU regulation must facilitate retail investors' access to straightforward instruments like corporate bonds. Contrary to this aim, as demonstrated in this paper, retail investors' access to such instruments has significantly declined due to new regulatory obstacles. In the context of RIS, we recommend that policymakers carefully consider implementing essential changes to advance these objectives.

The issuance of ordinary shares and bonds primarily serves the purpose of raising funds for an issuer. Therefore, they should not be perceived as investment products tailored to meet clients' expectations. Consequently, they should not be subject to ***product governance rules***.

In practice, these rules are not well-suited for such instruments. Notably, the requirement to define a Target Market lacks added value in terms of investor protection, as these financial instruments are primarily distributed passively through execution services, which do not involve aligning clients' characteristics with the target market (aside from knowledge and experience when providing execution services with the appropriateness test).

This lack of added value does not justify the significant burden resulting from the requirement and the sheer volume of financial instruments involved (for instance, on a single trading day on Euronext, at least 150,000 different ISIN codes of ordinary shares and bonds are traded).

Other product governance rules are also irrelevant for these types of financial instruments, such as cost assessment (since there are no product costs associated with them), performance scenarios, regular review, or target market. The application of product governance rules thus poses practical challenges, discouraging distributors from offering these simple financial instruments on the secondary market.

Ordinary shares and bonds should be distributed without these inappropriate restrictions, operating under the safeguards provided by MiFID II distribution regimes.

On the contrary, the current scope of PRIIPs is defined in a manner that encompasses all types of bonds. Although the newly proposed exemption for bonds with make-whole clauses by the Commission in the RIS proposal is a positive step forward, it falls short of encompassing all ordinary bonds (excluding structured bonds) for which the application of PRIIPs is irrelevant and poses an obstacle to their distribution. This contradicts the objectives of the CMU.

Consequently, to avoid falling within the scope of PRIIPs, ***issuers of ordinary bonds opt to exclude retail investors*** from the distribution of these financial instruments through selling and/or transfer restriction clauses in the prospectus, even when there is no specific feature related to the financial instrument justifying the exclusion. Distributors intending to sell these products to retail clients face additional risks and administrative burdens, as these clients may fall outside the positive target market or into the negative target market. Furthermore, as these financial instruments may qualify as PRIIPs even if they are ordinary, the absence of a KID presents a further obstacle to distribution to retail clients.

As a result, these bonds are typically unavailable to retail investors (as illustrated by the data shown in the sections below), thereby restricting retail access to the bond market. For these reasons, we recommend that all ordinary bonds (including those issued by financial issuers for funding purposes) should be exempted from the scope of the PRIIPs Regulation.
Hence, Euronext, while supportive of the Commission's exemption of bonds with a make-whole clause, advocates

for ***additional exemptions for all categories of ordinary bonds (excluding structured bonds) from the scope of PRIIPs and the product governance requirements within MiFID II.***

We believe that such measures would further reinforce the primary objectives of the proposal and encourage greater participation by retail investors in European capital markets.

The primary focus of the analysis conducted in this White Paper revolves around corporate bonds traded on the ***Bond-X segment of the EuroTLX Market***, an MTF primarily oriented towards credit trading for retail investors. EuroTLX stands out due to the fact it mandates at least one Liquidity Provider, also known as a Market Maker, for each instrument admitted to the market. These entities bear the responsibility for initiating the admission process for new bonds.

The data in this White Paper demonstrates how we have now arrived at a paradoxical situation where senior bonds issued by corporations with shares listed on a European Regulated Market can be restricted to professional investors, while the shares remain accessible to retail investors. Such an outcome cannot be deemed consistent with the protection of non-professional investors, whether from a substantial perspective or merely theoretical.

Rise in corporate bonds inaccessible to retail investors:

As evidenced in the table below, the quantity of corporate bonds listed on the market experienced a decline from 2018 to 2023. This trend primarily stems from the EuroTLX Market's emphasis on retail investors, leading Market Makers to concentrate their activities on instruments more appealing to retail flows, such as government, emerging markets, banking and financial bonds, rather than corporate bonds. However, we have also witnessed an increase in ***the number of professional only bonds*** to the detriment of those accessible to retail investors, further highlighting this shift.

	Listed	Prof Only	% of Prof
2018	639	46	7%
2019	637	99	16%
2020	645	135	21%
2021	613	152	25%
2022	568	151	27%
2023	539	150	28%

Despite considerable efforts by both the market and market makers to admit bonds accessible to retail investors, the percentage of corporate bonds dedicated to professional investors remains high and has continued to increase compared to the total number of instruments admitted to the EuroTLX Market.

The findings from this table are evident: there are fewer tradable corporate bonds on the market, and even fewer are accessible for trading by non-professional investors. Consequently, this dynamic leads to a gradual limitation of investment opportunities for retail investors.

Trading volumes in corporate bonds categorized as Retail vs. Professional Only:

The table below presents key figures regarding trading activity in corporate bonds from 2021 to 2023.

	Retail		Prof Only	
	n. trades	CTV ml€	n. trades	CTV ml€
2021	335	7,96	53	5,17
2022	448	9,57	53	4,68
2023	363	7,72	55	5,29

The table above illustrates the average daily number of trades and turnover traded in corporate bond instruments from 2021 to 2023, comparing retail instruments to professional-only instruments.

The increase in number of trades from 2021 to 2023 shows the continuous interest from retail investors in these types of instruments.[1]

These results can be attributed to the ongoing interest of non-professional investors in corporate bonds, indicating greater liquidity in bonds accessible to retail investors. Consequently, there are limited benefits to the development of capital markets through instruments dedicated solely to professional investors, as the liquidity in such instruments is significantly lower compared to those open to retail investors.

Why is an instrument featuring a make-whole call[2] provision categorised as suitable only for professional investors?

When an instrument falls under the category of a PRIIP, as per the regulation, a Key Information Document (KID) is mandated for its sale to retail investors. Corporate issuers, when opting to raise capital through new bonds, typically take various measures to circumvent additional obligations and risks stemming from the PRIIPs Regulation. Furthermore, they often lack incentive to create a KID, particularly when the entire issuance amount is already underwritten by a syndicate of professional investors. Consequently, the majority of bonds issued by corporations and classified as PRIIPs are restricted in terms of retail investor access. This scenario poses particular challenges, as even bonds with straightforward payoff structures, such as fixed rates, are labeled as PRIIPs due to the inclusion of a make-whole clause in the prospectus. It is crucial to note that make-whole clauses

[1] 2022 was an outlier due to different factors that contributed to an increase in the number of corporate bonds on the market, such as the war on Ukraine and the consequent increase in energy costs.

[2] A make-whole call provision is a call provision on a bond allowing the issuer to pay off remaining debt early. The issuer often makes a lump-sum payment to the investor equal to the net present value of all scheduled coupon payments and the principal.

serve as valuable means for protecting investor interests, especially when compared to simple call clauses.

2023 - Corporate EuroTLX Call (Prof Only)		
Coupon Type	Standard Call	Make-Whole
Fixed	17	120
Multi coupon	1	1
Variable	1	6
TOTAL	19	127

In the table above, examining the instruments listed on the Bond-X segment by the end of 2023, the data clearly indicates that the majority of call options included in corporate bonds' prospectuses are make-whole clauses.

Modifying the PRIIPs definition to exclude the make-whole call provision could potentially result in the lifting of restrictions for retail investors to access these instruments, thereby opening up a significant number of instruments to retail investors.

A cross-analysis conducted on corporate bonds lacking a call option demonstrates that when a call option is absent from the prospectus, these instruments become accessible to retail investors.

2023 - Corporate EuroTLX NO Call		
	Retails	Prof only
Fixed	159	15
Step Coupon	2	
Variable	5	2
TOTAL	166	17

This suggests that by removing the make-whole call provision from the PRIIPs definition, a substantial number of bonds currently restricted from retail access would become available.

In summary, the findings presented in this paper clearly illustrate that these regulations have significantly limited retail investor access to corporate bonds, regardless of their financial status. Consequently, retail investors have redirected a significant portion of their savings from traditional instruments, including the majority of existing corporate bonds, towards other instruments issued by the same entity but with more risk for retail investors, e.g. shares or certificates and covered warrants that replicate the performance of different underlyings.

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